

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

North Shore Gas Company	:	
	:	
Proposed general increase in rates	:	Docket No. 14-0224
for gas distribution service	:	
	:	
	:	(cons.)
The Peoples Gas Light and Coke	:	
Company	:	
	:	
	:	Docket No. 14-0225
Proposed general increase in rates	:	
for gas distribution service	:	

**REPLY BRIEF ON EXCEPTIONS OF THE
STAFF OF THE ILLINOIS COMMERCE COMMISSION**

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**REPLY BRIEF ON EXCEPTIONS OF THE
STAFF OF THE ILLINOIS COMMERCE COMMISSION**

Staff of the Illinois Commerce Commission (“Staff”), by and through its counsel, pursuant to Section 200.830 of the Rules of Practice (83 Ill. Adm. Code 200.830) of the Illinois Commerce Commission’s (“Commission”), respectfully submits this reply brief on exceptions (“RBOE”) to the briefs on exceptions (“BOE”) filed by: North Shore Gas Company (“North Shore” or the “Company”) and The Peoples Gas Light And Coke Company (“Peoples Gas” or the “Company”) (collectively referred to as the “Companies” or “Utilities”) (“the Companies’ BOE” or “Companies BOE” or “NS PGL BOE”); The People of the State of Illinois *ex rel.* Lisa Madigan, Attorney General of the State of Illinois (the “AG”) (“AG’s BOE Brief” or “AG BOE”); jointly, the Citizens Utility Board (“CUB”), the City of Chicago (“City”) and Illinois Industrial Energy Consumers (“IIEC”) (jointly “CCI”) (“CCI’s BOE” or “CCI BOE”); IIEC (“IIEC’s BOE” or “IIEC BOE”), and the Environmental Law & Policy Center (“ELPC”) (“ELPC’s BOE” or “ELPC BOE”) which were filed on December 16, 2014, in response to the Proposed Order issued by

the Administrative Law Judges (“ALJs”) on December 5, 2014 (“Proposed Order”, “PO” or “ALJPO”).

I. INTRODUCTION

A. Overview/Summary

II. TEST YEAR (Uncontested)

III. REVENUE REQUIREMENT

A. North Shore

B. Peoples Gas

C. Proposed Reorganization

CCI takes exception to the ALJPO for not imposing six conditions on the Companies as part of the Commission’s rate order in this consolidated proceeding.

CCI’s conditions are the following:

1. Order the Companies to report any significant change in their costs of providing regulated services, and any significant change in amounts allocated to the Companies from other affiliates, so the Commission can assess the appropriateness of possible orders to show cause why NS-PGL rates should not be reduced;
2. Order the Companies to separately track and record all costs, whether expenses or investments, associated with the reorganization (including costs attributable to transitions to common accounting, computer and other management systems, to mergers of organization structures, and consolidation of operations), so that the Commission can assure that costs unrelated to the Companies’ provision of regulated services are not included in regulated rates.¹
3. Order the Companies to report their actual costs and revenues, with costs attributable to the reorganization excluded and separately stated, with a view to prompt investigation (through show cause proceeding or otherwise 220 ILCS 5/9-202; 5/9-250), if indicated, of whether the Companies’ approved rates continue to be just and reasonable;

¹ This 2nd condition is not specifically identified in CCI’s BOE; however, this condition was proposed by CCI in its IB and CCI’s BOE exceptions language refers generally to the conditions proposed by CCI as all being appropriate.

4. Order the Companies to file new rates by a date certain (or within a specified period after the reorganization) that reflect (through an appropriate test year) the changed conditions occasioned by the reorganization;
5. Order the Companies (a) to limit any post-reorganization dividend pay-outs from the Companies to any affiliates to a level representative of pre-reorganization pay-outs and (b) to report any dividend pay-outs to the Commission within 30 days of such pay-outs; and
6. Order the Companies to report to the Commission, within 14 days of the change, any changes by credit rating agencies to their credit ratings of, or their recommendations concerning, the Companies or any affiliates.

(CCI BOE, 2-3, 8.) As Staff set forth in its RB, Staff agrees with the Companies that the appropriate place for the Commission to order conditions regarding the reorganization is in the reorganization docket, Docket No. 14-0496. (Staff RB, 3-4.) Staff added that if the Commission disagreed and decided that this proceeding is a proper forum to address the CCI conditions, then Staff is not opposed to or supports certain conditions proposed by CCI in this docket²:

- Condition one – Staff supports with modification that the report be filed on e-Docket,
- Condition two - Staff supports with no modification, and
- Condition three – Staff supports with modification clarifying the timing and method of supplying the information.

(*Id.*, 4.) With respect to conditions four, five and six, Staff's position is as follows:

- Condition four - Staff has concerns about Commission's authority to order the Companies to file a rate case with a specific test year. (*Id.*, 5.)
- Condition five - Staff cannot support any condition to limit post merger activity before the Commission rules on the proposed reorganization given

² In Docket No. 14-0496, intervenors, City-Cub, through the testimony of a Mr. Gorman did propose a condition limiting dividends, however, neither CUB, the City or IIEC proposed conditions one through four or six as conditions for the reorganization.

that not all parties in the reorganization docket are parties to the rate case proceeding, but could support a condition that requires the Companies to report on dividends payments to the Commission and the Commission's Finance Department Manager. *Id.*

- Condition six - Staff can support the condition with respect to the utility companies and Integrys, but has concerns with the Commission's authority to impose the condition on WEC who is not a party to the rate case, outside of the reorganization docket. (*Id.*, 6.) However, if the sixth condition was imposed by the Commission in this rate case, Staff recommends that the condition require the reporting of all reports credit agencies issue on the Companies. *Id.*

CCI's position is that the Commission must impose the conditions on the Companies in this proceeding. CCI argues that "within a few months of the effectiveness of the rates determined in this case, the Companies' costs of service and other relevant circumstances could be fundamentally altered" and the conditions are designed to "assure that the Commission is timely informed of any such changes, and has the appropriate information to allow it to expeditiously take whatever action is necessary, to protect the interests of ratepayers, in light of the potentially substantial changed circumstances resulting from the reorganization, if approved." (CCI BOE, 3.) Staff continues to recommend that the Commission address the issues in the reorganization docket. While it is certainly plausible that conditions one, two, three and six, which basically are requests for information, would provide the Commission with information sooner if the condition were imposed in the rate case rather than waiting for the reorganization docket to impose the condition, the difference in time between when the conditions would be imposed on the Companies is only approximately six months.³

³ A final order in the rate cases is expected no later than January 20, 2015 and a final order in the reorganization docket is expected by July 6, 2015.

Also, not all of the conditions CCI seeks to impose on the Companies are requests for information. Conditions, four and five, would restrict the Companies' and or its affiliates' actions and only the utility companies are parties to this docket. Staff has concerns about the Commission's general authority to impose the fourth condition and to impose the four and fifth conditions outside of the reorganization docket. (Staff RB, 5.) CCI's BOE does not address the authority issue with respect to conditions four and five but rather focuses its arguments on the reporting conditions. (CCI BOE, 7.)

Based upon the above, Staff cannot support CCI's request to impose conditions four and five in this proceeding. With respect to conditions, one, two, three, and six, Staff recommends that the Commission hold off on addressing the conditions until the reorganization docket⁴. Accordingly, Staff recommends that the Commission reject CCI's Exception No. 1.

⁴ As noted above, to date, only condition five has been proposed in the reorganization docket, Docket No. 14-0496.

IV. RATE BASE

A. Overview/Summary/Totals

- 1. North Shore**
- 2. Peoples Gas**

B. Potentially Uncontested Issues (All Subjects Relate to NS and PGL Unless Otherwise Noted)

1. Gross Utility Plant

- a. 2013 Plant Balances⁵**
- b. 2014 Plant Balances (other than PGL AMRP Additions and associated items addressed in Section IV.C.1.a)**
- c. 2015 Forecasted Capital Additions**
 - i. In General**
 - ii. Calumet System Upgrade (PGL)**
 - iii. Casing Remediation (PGL)**
 - iv. Gathering System Pipe Replacement Project (PGL)**
 - v. LNG Control System Upgrade (PGL)**
 - vi. LNG Truck Loading Facility (PGL)**
 - vii. Reclassification of Costs to Plant in Service (PGL)**
 - viii. Wildwood/Gages Lake (NS)**
 - ix. Grayslake Gate Station (NS)**
 - x. Casing Remediation (NS)**
 - xi. Locker Room (NS)**
- d. Original Cost Determinations as to Plant Balances as of December 31, 2012**

⁵ The term plant balances as used in this outline includes Construction Work in Progress not accruing AFUDC.

2. **Accumulated Provisions for Depreciation and Amortization (including new depreciation rates and including derivative impacts other than in Section IV.C.1.a)**
3. **Cash Working Capital (other than Section IV.C.2)**
4. **Materials and Supplies, Net of Accounts Payable**
5. **Gas in Storage**
6. **Budget Plan Balances**
7. **Accumulated Deferred Income Taxes**
 - a. **Incentive Compensation**
 - b. **Net Operating Losses**
 - c. **Derivative Impacts (other than in Section IV.C.1.a)**
8. **Customer Deposits**
9. **Customer Advances for Construction**
10. **Reserve for Injuries and Damages**
11. **Other**
- C. **Potentially Contested Issues (All Subjects Relate to NS and PGL Unless Otherwise Noted)**
 1. **Plant**
 - a. **2014 AMRP Additions (including derivative impacts on Accumulated Depreciation and Accumulated Deferred Income Taxes) and Associated Cost of Removal (PGL)**

Peoples Gas presents in its BOE an updated adjustment to the revenue requirement based upon (1) data in and derived from the post-hearing data through November 2014 plus (2) Peoples Gas' December 2014 costs as previously estimated in its rebuttal. The Company opines that its update results in middle ground figures. (NS PGL BOE, 15-16) Staff agrees. Below is the updated summary of the Company's

positions (Rebuttal and BOE), the AG's position, and actual data as of November 2014 (emphasis added on updates).

	Peoples Gas Rebuttal ⁶	Attorney General ⁷	Actual Through 11/2014 ⁸	Peoples Gas BOE ⁹
Gross Utility Plant	\$173,237,532	\$115,986,348	\$130,076,152	\$144,512,614
Accum. Depreciation, Retirements and Cost of Removal	58,686,380	33,721,806	36,093,442	40,847,793
Net Utility Plant	\$231,923,912	\$149,708,154	\$166,169,594	\$185,360,407
Accum. Deferred Income Taxes	(16,463,375)	(8,603,652)	(7,879,738)	(9,953,619)
Total Rate Base	\$215,413,992	\$141,104,502	\$158,289,856	\$175,406,788

Based upon the above, it is clear that the AG's position for 2014 has been exceeded by the actual activity through November. (\$141 vs. \$158 million). Further, the December 2014 forecast additions of \$16.7 million¹⁰ appears reasonable in the range of recent months' activity, from \$20 to \$45 million in the months ranging August through November 2014.¹¹ Therefore, Staff agrees with the language changes (language assuming Peoples Gas' proposed updates) to the Findings and Ordering Paragraphs that Peoples Gas proposes to adopt the updates. (NS PGL BOE Exceptions, 243-244) Staff provides that language below, for the convenience of the

⁶ NS PGL Ex. 22.14 P, p. 1.

⁷ NS PGL Ex. 37.5 P, p. 3.

⁸ Staff Ex. 13.0, p. 29.

⁹ NS PGL BOE Attachment 1 Workpaper, p. 24.

¹⁰ Company Rebuttal Workpaper NS PGL Ex. 22.0 WP-7 REV, p. 7; also at NS PGL BOE Attachment 1 Workpaper, p. 24.

¹¹ NS PGL BOE Attachment 1 Workpaper, p. 24.

parties, and additionally recommends an edit of its own adding a total rate base impact amount shown in bold, gray shading and underline.

- (24) Peoples Gas shall reflect in its Rider QIP Surcharge Percentage following the date of this Order the variance from the 2014 QIP amounts included in base rates to its actual 2014 QIP amounts, which may be an increase or decrease to the amount to be recovered through the Rider QIP Surcharge Percentage. The 2014 QIP amounts included in base rates are comprised of ~~\$115,986,348~~\$144,512,614, less a negative amount of ~~\$33,721,806~~\$40,847,793 for accumulated depreciation and less a positive amount of ~~\$8,603,652~~\$9,953,619 for accumulated deferred income taxes, and ~~\$1,728,342~~\$1,477,502 for annualized depreciation expense less annualized depreciation expense applicable to the plant being retired, **for a total rate base amount of \$175,406,788;**

...

IT IS FURTHER ORDERED that The Peoples Gas Light and Coke Company shall reflect in its Rider QIP Surcharge Percentage following the date of this Order the variance from the 2014 QIP amounts included in base rates to its actual 2014 QIP amounts, which may be an increase or decrease to the amount to be recovered through the Rider QIP Surcharge Percentage. The 2014 QIP amounts included in base rates are comprised of ~~\$115,986,348~~\$144,512,614, less a negative amount of ~~\$33,721,806~~\$40,847,793 for accumulated depreciation and less a positive amount of ~~\$8,603,652~~\$9,953,619 for accumulated deferred income taxes, and ~~\$1,728,342~~\$1,477,502 for annualized depreciation expense less annualized depreciation expense applicable to the plant being retired, **for a total rate base amount of \$175,406,788;**

Further, Staff recommends the ALJs incorporate into Peoples Gas' revenue requirement the adjustment reflected on pages 2-3 of the Company's BOE, Attachment 1 Work Paper, inclusive of the federal, state, and deferred income tax effects, as well as investment tax credits. (See lines 28 through 31 of page 3). Staff understands that adoption of the Company's tax calculations addresses the slight calculation errors as discussed in the Company's Exception No. 3.

2. Cash Working Capital

a. OPEB lead

The Companies dispute the ALJPO's conclusion that the cash working capital ("CWC") leads for post-employment benefits other than pensions ("OPEB") should be revised to 170.00 and 169.91 for North Shore and Peoples Gas, respectively. (NS PGL BOE, 18.) The ALJPO correctly rejects the Companies' repeated arguments, which Staff addressed in its Initial and Reply Briefs. (Staff IB, 15-18, Staff RB, 12-13.) Staff will not repeat these arguments. Therefore, based upon those arguments, the Companies' primary proposed language changes to adopt negative OPEB leads based on the early 2012 OPEB payment dates should be rejected. (NS-BOE Exceptions, 47-48.)

The Companies' alternatively propose that the Commission's recent decision in Commonwealth Edison Company, ICC Docket No. 14-0312 (Order Dec. 10, 2014) ("ComEd FR4"), should be controlling, and present language to adopt zero OPEB leads for both Companies. (NS PGL BOE, 19-21; NS-BOE Exceptions, 48.) ComEd FR4 states in part:

The evidence shows that ComEd's pension expense has been applied as a reduction to ComEd's pension asset and that the OPEB expense is included as a component of operating reserves, which reduces rate base. (ComEd FR4, 13.)

The remainder of the Companies' conclusion cites to the past precedent of using zero in ComEd FR4. It is unclear what evidence led to the ComEd FR4 conclusion. However, it is clear that there was no record of an early OPEB (or pension) payment date driving the results of the CWC lead/lag study in ComEd FR4, as exists in the evidence here in this proceeding. The law is clear that the Commission must decide this case on the

evidence presented in this record. (220 ILCS 5/10-103, 10-201(e)(iv)(A)). The Companies presented their alternative theories on a zero OPEB lag in their rebuttal case. The ALJPO properly rejected those theories, and the issuance of ComEd FR4 based on a different set of facts provides no rationale to change that sound conclusion.

3. Retirement Benefits, Net

The Companies' BOE provides no new insight into this issue, and therefore their exceptions should be rejected. The Commission time and time again, most recently just a little over a month ago in MidAmerican Energy Company's 2014 rate case (Docket No. 14-0066) has found that utilities may not get a return on ratepayer supplied funds, which the pension asset is. The Companies argue five reasons for reconsiderations of the Commission's prior Orders on this issue, however, these arguments are not new and provide no reason for the Commission to reconsider and change its long standing position on this issue. (NS-PG BOE, 23-26.) The ALJPO correctly rejected each of the previously requested (NS-PG IB, 41-43) reconsiderations, discussed below.

First, the Companies ask for reconsideration based on their erroneous conclusion from N.Y. Bd. of Pub Util. Comm'rs v. New York Telephone Co., 271 U.S. 23, 46 S.Ct. 363, 70 L.Ed. 808 (1926) that there is no legal basis for treating earnings as ratepayer-supplied funds. (NS PGL IB, 41.) The Commission has previously rejected the Companies' requests to reconsider based on this cite to an eighty-seven year old case, and should do so again here. Peoples Gas 2012, 81; North Shore Gas Company and The Peoples Gas Light and Coke Company, ICC Order Docket Nos. 11-0280/11-0281 (Cons.), 30 (January 10, 2012)("Peoples Gas 2011.")

The case cited by the Companies, New York Board of Public Utility Commissioners, is essentially a retroactive ratemaking case. Staff is aware of the issue of retroactive ratemaking as well as Illinois case law on the issue. (See, Mandel Brothers, Inc. v. Illinois Commerce Comm'n, 2 Ill. 2d 205, 210 (1954) and a number of subsequent decisions (Citizens Utilities Co. v. Illinois Commerce Comm'n, 124 Ill. 2d 195, 206-211 (1988)). The Companies have not argued that Staff's position is retroactive ratemaking, which it is not; therefore, the eighty-seven year old case is not relevant to the issue in this case. The Companies are seeking to collect monies from ratepayers and then charge those ratepayers with a return on investment of those monies. What is relevant, which the Companies have not disputed, is that under Illinois law for ratemaking purposes a public utility may not receive a return on investment from ratepayers for ratepayer-supplied funds. (City of Alton v. Illinois Commerce Comm'n, 19 Ill. 2d 76, 85-6 and 91 (1960); DuPage Utility Co. v. Illinois Commerce Comm'n, 47 Ill. 2d 550, 554 and 558 (1971); and Central Illinois Light Co. v. Illinois Commerce Comm'n, 252 Ill. App. 3d 577, 583-3 (3rd Dist., 1993). See also Business and Professional People for the Public Interest v. Illinois Commerce Comm'n ("BPI II"), 146 Ill. 2d 175, 258 (1991)) (Staff IB, 26-27.) In addition, with respect to New York Board of Public Utility Commissioners, as long ago as 1975, the Federal Power Commission, the predecessor of the FERC, observed that accounting practices had changed substantially between the New York Telephone decision and the matter then under consideration, to the point where the Federal Power Commission found New York Telephone entirely distinguishable. Order on Rehearing, Municipal Light Boards of Reading and Wakefield,

Massachusetts, et al., v. Boston Edison Company, 54 F.P.C. 440, 1975 WL 14328 (F.P.C. 1975).

Second, the Companies argue that ownership of the pension assets on their balance sheets allows for reconsideration. (NS PGL BOE, 23.) Staff has explained how ownership of the pension trust fund is not relevant. (Staff IB, 26.) (Contributed plant may be owned by a utility, but a utility does not earn a return on plant contributed by a customer.) The Commission previously considered and rejected this ownership argument, by the Companies. (North Shore Gas Company and the Peoples Gas Light and Coke Company, ICC Order Docket Nos. 12-0511/0512 (Cons.) 81 (June 18, 2013); North Shore Gas Company and the Peoples Gas Light and Coke Company, ICC Order Docket Nos. 11-0280/0281 (Cons.) 29-30 (January 10, 2012).) This argument is not new, and not a basis for reconsideration.

Third, the Companies present as an argument for reconsideration the fact that the rates on which customers' bills are based reflect the accrual of pension expense. (NS PGL BOE, 23.) The fact that the Companies will receive the full amount of actuarially determined pension expense in the revenue requirement is not a basis to allow a return on ratepayer supplied funds. (Staff IB, 22-23.) Further, nothing has changed here, i.e., past Orders which rejected the Companies' position also determined rates based on the accrual of pension expense. (e.g., Peoples Gas 2012, 81.) Thus, this argument is not new nor a basis for reconsideration.

The fourth argument for reconsideration from the Companies is their theories on normal operating revenues and their relationship to retained earnings. (NS PGL BOE, 24.) The Companies highlight that this argument was raised both in Peoples Gas 2011

and 2012 rate cases, omitting the fact that it was rejected by the Commission in both of those cases. (NS PGL BOE, 24.) Staff has discussed how the prior Orders are valid and that the Commission is not required to make a particular finding as to each evidentiary fact or claim made by a party. (Staff IB, 18-19.) Thus, this argument is not new and not a basis for reconsideration.

Finally, the Companies assert that cumulative pension contributions in excess of cumulative pension expense is a basis for reconsideration. (NS PGL BOE, 24.) The Commission has never allowed a return on a pension asset based on this type of historical analysis of pension contributions versus expense. (Staff IB, 22.) Nonetheless, the facts in this case are that Peoples Gas made no contributions into the qualified pension plan during 2013 and 2014, and the Companies' updated actuarial reports reflect zero employer contributions for the year 2015 for both utilities. (Staff IB, 23.) The only time the Commission has allowed a return on pension plan payments was when the utility could show a specific contribution from shareholders created a pension asset. (Staff Ex. 6.0, 12) The Companies have not shown that in this proceeding.

The Companies present no evidence or arguments not considered by the ALJPO and properly rejected. The Companies' Exception No.8 must be rejected.

V. OPERATING EXPENSES

A. Overview/Summary/Totals

- 1. North Shore**
- 2. Peoples Gas**

B. Potentially Uncontested Issues (All Subjects Relate to NS and PGL Unless Otherwise Noted)

- 1. Other Revenues**
- 2. Resolved Items**
 - a. Incentive Compensation**
 - b. Executive Perquisites**
 - c. Interest**
 - i. Budget Payment Plan**
 - ii. Customer Deposits**
 - iii. Synchronization (including derivative adjustments)**
 - d. Lobbying**
 - e. Fines and Penalties**
 - f. Plastic Pipefitting Remediation Project (PGL)**
- 3. Other Production (PGL)**
- 4. Storage (PGL)**
- 5. Transmission**
- 6. Distribution**
- 7. Customer Accounts – Uncollectibles**
- 8. Customer Accounts – Other than Uncollectibles**
- 9. Customer Services and Information**
- 10. Administrative & General (other than items in Section V.C)**

11. Depreciation Expense (including derivative impacts other than in Section IV.C.1.a)
 12. Amortization Expense (including derivative impacts)
 13. Rate Case Expense (other than amortization period in Section V.C.4)
 14. Taxes Other Than Income Taxes (including derivative impacts)
 15. Income Taxes (including derivative impacts)
 16. Reclassification of Costs to Plant in Service (PGL)
 17. Gross Revenue Conversion Factor
 18. Other
 - a. Invested Capital Tax
- C. Potentially Contested Issues (All Subjects Relate to NS and PGL Unless Otherwise Noted)
1. Test Year Employee Levels
 - a. Peoples Gas
 - b. North Shore
 2. Medical Benefits
 - a. Peoples Gas
 - b. North Shore
 - c. IBS
 3. Other Administrative & General
 - a. Integrys Business Support Costs
 - i. Labor
 - ii. Benefits
 - iii. Postage
 - iv. Legal (NS)

v. ICE Project

The AG's Exception 2 proposes to reverse the ALJPO conclusion on the costs of the Integrys Customer Experience ("ICE") Project. (AG BOE, 9-20) In addition to a discussion of the evidence presented, and rejected, in briefs, the AG relies on the granting of its Motion to Admit New Information ("Motion"), granted November 10, 2014, i.e. after briefs were submitted. (AG BOE, 16) The data request ("DR") in question (DR AG 3.05) is a follow up to a DR from the reorganization case (DR AG 2.13). AG 2.13 was followed up in the instant proceeding in DR series DLH 35 and entered into the record as Staff Group Cross Ex 2.

Staff Group Cross Ex. 2 shows that DR AG 2.13 (and follow up series DR AG 3.05 granted in the Motion) are probing into a long term forecast provided in the reorganization docket. The Companies state in Staff Group Cross Ex. 2 that the long term forecast changed in 2013 and was not used for the test year. The Companies further state in Staff Group Cross Ex. 2 that the ICE Project's in-service date changed, which would affect the consistency of information between the two DR responses. The Companies have explained in discovery, on the record, and on the witness stand, the current status (in service date, date of benefits; Staff IB, 36) and the AG continues to rely on an out of date forecast. Further, the granting of the AG's Motion does not bind the ALJ or Commissioners to analyze the evidence in the Motion as the AG advocates.

(a) Return on Assets and Depreciation

(b) Non-Labor

b. Advertising Expenses

c. Institutional Events

d. Charitable Contributions

In their BOE, the Companies take exception to the ALJPO 's adjustment for charitable contributions which do not provide a benefit to ratepayers because the contributions were made outside of the Companies' service area. (NS/PGL BOE, 27.)

The ALJPO appropriately exercises the Commission's discretion in determining whether these charitable contributions are reasonable expenses to recovery from ratepayers. (ALJPO, 105-106.) The Companies argue that 220 ILCS 5/9-227 forbids the Commission from making disallowances based on a rule. (NS/PGL BOE, 28.) That argument is irrelevant since no rule is cited in the ALJPO. The Companies do not provide any argument that the Commission is forbidden from considering whether expenses are just and reasonable.

The Companies also note that the charitable contributions are in communities where its employees live. (NS/PGL BOE, 28.) The Commission correctly made its determination of whether it is reasonable to recover charitable contributions from ratepayers based on the service area of the ratepayers; not where Company employees live. Recovering expenses from ratepayers for the benefit of the communities of Company employees would be contrary to the interest of ratepayers. The Commission should reject the Companies' exception.

e. Social and Service Club Membership Dues

4. Amortization Period for Rate Case Expenses

The Companies main argument against the ALJPO's rate case expense amortization period is that the Commission should ignore available information in making its decision. (NS/PGL BOE, 29.)

The ALJPO's correct decision on rate case expense amortization period of two and one-half years is based on the Companies' assertions of the likely timing of its next rate case. (Staff IB, 41.) The Companies are in the unfortunate position of having to argue against their own assertions. They ironically provide an excellent rationale for an amortization period even longer than two and one-half years due to the complexity of a merger proceeding which involves multiple out-of-state regulatory authorities. (NS/PGL BOE, 29.)

The Companies also argue that Staff and CCI do not take into consideration that ratemaking proceedings could occur earlier than anticipated under certain circumstances that the Companies do not believe will occur. (NS/PGL BOE, 30.) The Commission should join the Companies in believing that these undefined circumstances will not occur. Therefore, the Commission should reject the Companies' exception.

5. Peer Group Analyses

VI. RATE OF RETURN

A. Overview

The Companies argue that the Commission should reject the ALJPO's return on equity and overall rate of return recommendation because it does not result in an increase in the authorized return on equity and overall return over the currently authorized levels. (NS PGL BOE, 30-32.) The ALJPO considered all the analyses

submitted by the parties to this case, concluded that Staff's analysis was superior, and provided the rationale for its rejection of the Companies' recommendations. (ALJPO, 112-145.) Staff urges the Commission to adopt the findings of the ALJPO and reject the Companies' analysis.

B. Capital Structure

C. Cost of Short-Term Debt

The ALJPO correctly found that Staff's proposed costs of short-term debt based on actual interest rates are reasonable and supported by the evidence. (ALJPO, 116.) The Companies continue to argue that the costs of short-term debt should be based on forecasted interest rates. (NS PGL BOE, 32-35.) Staff demonstrated that current interest rates have been far more accurate in recent years than the forecasted interest rates that the Companies prefer, which have consistently overstated the actual interest rates that prevailed in the market. (Staff IB, 44-45; Staff RB, 26-28.) The Commission should adopt the ALJPO's conclusion that the appropriate cost of short-term debt is 0.74% for North Shore and 0.91% for Peoples Gas.

D. Cost of Long-Term Debt

The ALJPO appropriately concluded that professional forecasting services relied on by the Companies have consistently over estimated future rates in recent years. (ALJPO, 118.) The Companies urge the Commission to set the interest rates for planned 2015 issuances of Peoples Gas based on forecasts. (NS PGL BOE, 35-36.) Staff established that current interest rates have proven to be better predictors of future interest rates in recent years. (Staff IB, 46-49.) Hence the Commission should adopt

the ALJPO's conclusion that the appropriate cost of long-term debt for Peoples Gas is 4.26%.

E. Cost of Common Equity

The Order in the Companies' 2012 rate cases states "While **we adhere to the position that the Commission does not base utility returns on those approved for other utilities**, the Commission will consider general market conditions and trends to be apprised of current market conditions, but only to the extent such data are verifiable and unbiased. (North Shore Gas Company and the Peoples Gas Light and Coke Company, ICC Order Docket Nos. 12-0511/0512 (Cons.) 205 (June 18, 2013)(emphasis added.) The Companies continue to push for the Commission to use recent ROEs for other utilities as a guide for determining the investor-required rate of return to set rates in this proceeding. (NS PGL BOE, 36-41.) The Final Order in the Companies' 2007 rate cases rejected this same argument, stating:

[B]y determining the Utilities' ROEs via comparison to existing ROEs, the Commission would be disregarding its duty to impose only cost-based and reasonable rates on the Utilities' customers....It would require us to abandon the course we, along with other commissions, have charted for decades. Return determinations are appropriately based on a two-pronged analysis of utility-specific financial characteristics and financial market dynamics and conditions. We have relied upon the financial models and reasonable adjustments to accomplish this. Although even these quantitative mechanisms involve some degree of subjectivity and can, for that reason, be manipulated, they were constructed with the intention of objectively estimating the cost of equity, not to match another utility's ROE. (Order, Docket Nos. 07-0241/07-0242 Cons., February 5, 2008, 84.)

The Commission should disregard the Companies' argument that recent ROEs for other utilities demonstrate that Staff's ROE is "grossly inadequate," (NS PGL BOE, 41) as the

Companies failed to establish comparability and ignored past Commission orders that rejected determining ROEs via the comparison to existing ROEs for other utilities.

While ignoring prior Commission orders with regard to relying on the ROEs set for other utilities, the Companies argue that the investor-required rate of return on common equity should be consistent with the Commission's conclusions in past rate cases for North Shore and Peoples Gas. (NS PGL BOE, 41-43.) Unlike the Companies' prior rate cases, the ALJPO in this case concluded "The Commission rejects the Companies' significantly higher determination based in part on improperly massaged input values and analytic tools that the Commission has repeatedly rejected." (ALJPO, 144.) Hence, the balancing approach that the Companies advocate for would inappropriately include improper input values that inflate the cost of equity if the Companies' ROE recommendations were included. Importantly, the Companies' leverage adjustment inflated their DCF results by 46 basis points and their CAPM results by 43 basis points. (Staff Ex. 3.0, 32-33.) As Staff pointed out, eliminating the inappropriate leverage adjustments to the Companies' DCF and CAPM estimates would produce a cost of common equity of 9.22%. Incorporating a more appropriate growth rate estimate in the Companies' DCF analysis would produce a cost of common equity of 8.98%. These corrected costs of equity are much more in line with Staff's results and illustrate how the Companies' manipulated the data to inflate the cost of common equity to 10.25%. The Commission should follow the ALJPO and reject the Companies' cost of equity recommendations, including the leverage adjustment that serves to inflate the cost of equity.

The Companies reiterate their arguments against Staff's DCF and CAPM analyses. (NS PGL BOE, 43-49.) Staff has responded to these arguments. (Staff IB, 49-69; Staff RB, 28-33.) The Commission should disregard the Companies' criticisms as the ALJs did and adopt the recommendations of the ALJPO with regard to the investor-required rate of return on common equity. (ALJPO, 141-144.)

F. Weighted Average Cost of Capital

Staff supports the conclusions in the ALJPO with regard to the rate of return. The Commission should accept the ALJ's recommendations and adopt the following overall rate of return for the Companies:

North Shore Gas Company					
	Amount	Percent of Total Capital	Cost	Weighted Cost	
Long-term Debt	\$79,784,000	38.94%	4.13%	1.61%	
Short-term Debt	\$21,678,000	10.58%	0.74%	0.08%	
Common Equity	\$103,435,000	50.48%	9.05%	4.57%	
Total Capital	\$204,897,000	100.00%			
Weighted Average Cost of Capital				6.26%	
The Peoples Gas Light and Coke Company					
	Amount	Percent of Total Capital	Cost	Weighted Cost	
Long-term Debt	\$864,589,000	46.51%	4.26%	1.98%	
Short-term Debt	\$58,805,000	3.16%	0.91%	0.03%	
Common Equity	\$935,610,000	50.33%	9.05%	4.55%	
Total Capital	\$1,859,004,000	100.00%			
Weighted Average Cost of Capital				6.56%	

VII. OPERATIONS

A. AMRP Main Ranking Index and AG-Proposed Leak Metric(s)

B. Pipeline Safety-Related Training (Uncontested)

VIII. COST OF SERVICE

A. Overview

B. Embedded Cost of Service Study

1. Allocation of Demand-Classified Transmission and Distribution Costs

Response to IIEC

The IIEC take exception to the ALJPO's acceptance of the average and peak ("A&P") methodology for allocating demand-related transmission and distribution ("T&D") costs. They reiterate the same arguments as posited in their testimony. (IIEC BOE, 2-13.) However, as the ALJPO recognizes and Staff has explained, the IIEC's arguments fail to recognize that the A&P allocator serves two distinct purposes, to reflect class contributions to the system average and to the system peak. Accordingly, the A&P appropriately considers both average and peak demands in the allocation process. (Staff IB, 73.)

As Staff discussed in its initial brief, the Commission addressed IIEC's double counting argument previously in Docket No. 04-0476, Illinois Power Company's proposed general increase in natural gas rates. *Id.* The Commission concluded that:

While the IIEC argues that the A&P method improperly double counts average demand in allocating T&D plant costs, the Commission believes that when allocating T&D plant costs an emphasis on average demand is appropriate. The record demonstrates that the A&P method relies upon class average demands and class coincident peak demands, which by definition are numerically larger than the associated averages.

Illinois Power Company, ICC Order Docket No. 04-0476, 64-65
(May 17, 2005).

(Staff IB, 73.)

Additionally, Staff pointed out that in Central Illinois Public Service's ("CIPS") and Union Electric's ("UE") proposed general increase in natural gas rates, the Commission stated:

Furthermore, the Commission finds that the argument that the A&P method double counts average demand is not a sufficient basis for rejecting that approach. In fact, the Commission believes that when allocating demand costs it is the A&P method's emphasis on average costs rather than peak costs that justifies its adoption.

Central Illinois Public Service Company, ICC Docket Nos. 02-0798, 03-008 & 03-0009 (Cons.), 98 (October 22, 2003). (Staff IB, 73.)

In response to IIEC's argument that the A&P cost allocation method does not appropriately reflect how costs are incurred by the Companies, Staff explained that the A&P method allocates costs by both peak demands and average demands. The peak demand component recognizes that a T&D system is sized to meet maximum annual demands. However, there is also an average demand component because meeting peak demands is not the sole factor that shapes investment in a T&D system. Another factor, but not the only factor, is the economic motivation to construct a T&D system. This is more appropriately reflected by average demands than peak demands. This is because year-round demands are necessary to generate sufficient revenues to justify investment in a T&D system. These year-round demands are reflected in the average demand but not the peak demand portion of the A&P allocator. (*Id.*, 74.)

Other factors to consider are safety and reliability. Safety and reliability investments are more appropriately reflected in average demands. Safety and reliability are important, not just only for the peak day of the year, but for every day of the year that gas is consumed which is what the average demand component reflects. *Id.*

Additionally, there is strong precedent in Illinois for using the A&P demand allocator. The Commission typically uses this allocation methodology for the distribution costs of gas companies. In Central Illinois Public Service Company's ("CIPS") and Union Electric Company's ("UE")¹² proposed general increase in natural gas rates, Docket No. 04-0476, the Commission concluded:

The allocation method that properly weights peak demand is the A&P method, the same method that the Commission adopted in CIPS' and UE's last gas rate cases. The A&P method properly emphasizes the average component to reflect the role of year-round demands in shaping transmission and distribution investments.

Central Illinois Public Service Company, ICC Docket Nos. 02-0798, 03-008 & 03-0009 (Cons.), 98 (October 22, 2003).

The Commission also accepted the use of the A&P allocation methodology in Nicor Gas' 2004 rate case. Northern Illinois Gas Company, ICC Order Docket No. 04-0779, 102 (September 20, 2005) and Nicor Gas' most recent rate case Docket No. 08-0363.¹³ The Commission subsequently directed Peoples Gas and North Shore to employ the A&P demand allocation methodology to allocate the distribution costs in Docket Nos. 07-0241/07-0242 (Cons.). North Shore Gas Company, ICC Order Docket No. 07-0241/07-0242 (Cons.), 199 (February 5, 2008). Since then, the Companies

¹² CIPS and UE are now part of Ameren Illinois Company.

¹³ The A&P methodology was used again in Nicor Gas' 2008 rate case, Northern Illinois Gas Company, ICC Order Docket No. 08-0363, 72-77 (March 25, 2009).

have employed the A&P demand allocation methodology in their COS studies. In each case, the A&P methodology was approved by the Commission. (*Id.*, 75.)

The ALJPO correctly finds that the A&P allocation method of cost allocation is supported by the record and consistent with the method of allocation adopted in previous rate cases, accordingly IIEC's exceptions on this issue should be rejected.

2. Allocation of Small Diameter Main Service Costs

IX. RATE DESIGN

A. Overview

B. General Rate Design

1. Allocation of Rate Increase

Response to IIEC

IIEC's BOE states that it does not oppose the proposals by the Companies to rerun their embedded cost of service ("ECOS") studies and use the results to determine the increase (decrease) for each rate class if the Commission incorporates IIEC's proposals regarding the CP allocator and small main delineation. (IIEC BOE, 21-22.) In essence, the IIEC is implying that the ECOS studies are not flawed if the Commission accepts their positions, but they are flawed if their positions are rejected. If the Commission does not accept IIEC's proposals then an across the board increase should be used. However, the ALJPO's acceptance of the A&P allocation methodology and rejection of the small main adjustment in the ECOS studies provides a better representation of how costs are caused.

The ALJPO correctly rejects IIEC's proposed across the board increase method.

2. Fixed Cost Recovery

Response to NS PGL

The Companies take exception to the ALJPO's use of the term "SFV-based." (NS PGL BOE, 55, 58.) The Companies indicate that there is no objective meaning as used. However, Staff discussed SFV rate design and SFV-based rate design in its direct and rebuttal testimony. (Staff Ex. 4.0, 14; Staff Ex. 9.0, 9-11.) Staff stated:

A modified SFV rate design (also referred to as a SFV-based rate design) has both a fixed customer charge and a variable distribution charge; however, the fixed customer charge does not recover all costs but instead recovers a certain percentage of total fixed costs and the variable distribution charge recovers the remaining costs. The Companies' proposed rate design is a modified SFV rate design and they identify fixed costs as ECOS study customer and demand related costs. (Staff Ex. 4.0, 14.)

Staff further clarified the definitions in its rebuttal testimony in response to the Companies' breach of the subject. The Companies are attempting to muddy the subject of fixed cost recovery and the Commission's recent movement away from SFV-based rate design. The ALJPO correctly identifies the subject matter and the record evidence shows that the Commission should not change the ALJPO's conclusion regarding fixed cost recovery, except for the small changes Staff recommended in its BOE.

The Companies disagree with the ALJPO's contention that SFV rate designs are inconsistent with energy conservation. They state that the flaw with this reasoning is that it sends an inaccurate price signal. (NS PGL BOE, 56.) However, as Staff and other parties have discussed, recent Commission orders adopt rate designs that move away from a SFV-based rate design and instead align customers' bills with the cost of service (i.e., customer charges based upon ECOS study customer costs and distribution/demand charges based upon ECOS study demand costs). (Staff IB, 83-84.) It is clear the Commission is considering how rate design can be utilized to ensure that

customers are responsible for the demands they place on the system and that rate design encourages conservation efforts. Adoption of the Companies' rate design would create inconsistency between how costs are caused and how revenues are collected. For example, the Companies' proposed SFV-based rate design recovers some demand related costs, such as distribution mains, through the customer charge and therefore shifts cost recovery from a per therm basis to a per customer basis. The inconsistency arises because assigning demand related costs to the customer charge assumes each customer in the class contributes equally to the class demand. There is no evidence in the record to support this assumption. Furthermore, that assumption is inconsistent with the way demand costs are allocated among the customer classes. Demand related costs are allocated among customer classes based on demand, not based upon the assumption that each customer contributes equally to demand. (Staff RB, 45-46.)

The Companies also argue that if a gas main costs \$1,000, it will cost \$1,000 whether zero therms of gas flow through the main or one million therms of gas flow through that same main. They state that a rate design that places fixed costs in variable charges is premised on the fallacy that a customer using less gas causes lower amount of fixed costs. (NS PGL BOE, 56.) The Companies' statement misses the point. The relevant question here is not the cost of the infrastructure built to meet demand but rather who should pay for it. When demand costs are recovered through the customer charge, all customers are assumed to cost the same for the Companies to serve them. (Staff IB, 87.) When demand costs are recovered through the distribution charge, the recovery method assumes the costs are not the same for all customers to serve them. If demand costs are recovered through the distribution charge, that assumes that

customers with higher usage will have higher peak demands and be more costly to serve than small use customers. While this latter assumption may not be true in each and every case, it is more reasonable than the Companies' proposed rate design's implied assumption that all customers within a class cause the utility to incur the same amount of demand costs. A customer with a 4,000 square foot home would be expected to place greater demands on the system at the peak compared to the customer with a 1,000 square foot home. Recovering demand costs through the customer charge, as the Companies propose, does not recognize this difference. (Staff RB, 46-47.)

Finally, the Companies argue that the ALJPO understates or ignores the amount of a customer's bill that a customer may affect through conservation. (NS PGL BOE, 56.) However, as Staff has consistently stated, the Companies' approach does not encourage conservation as much as Staff's rate design, which recovers a greater share of costs through variable charges and thereby increases the financial incentive for customers to adopt conservation measures. Although gas costs comprise a portion of a customer's total monthly gas bill, the customer is still concerned about the total bill. Recovering distribution demand costs on a per therm basis increases the incentive to conserve. In contrast, the Companies' rate design recovers some of the demand costs on a per customer basis instead of a per therm basis. This causes the distribution charge to be lower compared to if all of the demand costs were recovered on a per therm basis. Thus, the price signal for ratepayers to conserve is weakened. (Staff RB, 47.)

The ALJPO correctly finds that SFV-based rates that assume that non-storage demand related distribution costs should be allocated on a *per* customer basis are

inconsistent with the public policies of attributing costs to cost causers, encouraging energy efficiency and eliminating inequitable cross-subsidization of high users by low users of natural gas. (ALJPO, 189-190.)

Response to IIEC

The IIEC proposes some language changes to the “Commission Analysis and Conclusion” of the ALJPO Fixed Cost Recovery section. (IIEC BOE, 24-29.) Staff recommends that one of IIEC’s edits be rejected. IIEC’s proposed edit changes the intent of the language. The IIEC edit is as follows:

It is patent that high customer charges mean the Companies' lowest users bear the brunt of rate increases, on a per-unit basis and ~~subsidize the highest energy users~~. Steadily increasing customer charges diminish the incentives to engage in conservation and energy efficiency because a smaller portion of the bill is subject to variable usage charges and customer efforts to reduce usage. (IIEC BOE, 28.)

Staff recommends that this edit be rejected because it substantially changes the meaning of the statement. Staff believes the ALJPO statement was intended to show that low therm users under a fixed cost recovery methodology subsidize customers that use more therms. The ALJPO’s language is found on page 189 of the ALJPO.

C. Service Classification Rate Design

1. Uncontested Issues

- a. Service Classification No. 8, Compressed Natural Gas Service (PGL)**
- b. S.C. No. 5 Contract Service for Electric Generation and S. C. No. 7 Contract Service to Prevent Bypass**

2. Contested Issues – North Shore and Peoples Gas

- a. Service Classification No. 1, Small Residential Service, Non-Heating**

Response to NS PGL

The Companies reject the ALJPO's conclusion regarding the S.C. No. 1 Small Residential Service, Non-Heating classes' rate design. They state that the ALJPO's acceptance of Staff's rate design is flawed because it is inconsistent with cost-based rate design. (NS PGL BOE, 58.) The Companies repeat their points that were addressed in the Fixed Cost Recovery Section IX.B.2.

Staff will not repeat its arguments that are discussed in the Fixed Cost Recovery section of this RBOE. The ALJPO correctly accepts Staff's rate design proposal for the class.

Response to AG

The AG agrees with the ALJPO's rejection of a movement toward greater fixed cost recovery. However, the AG continues to reject the ALJPO's proposal to accept Staff's rate design proposal. The AG recommends that the ALJPO accept its rate design proposal instead. The AG states that Staff's proposal actually increases fixed cost recovery and therefore should be rejected. (AG BOE, 20-21.) However, as Staff has discussed through out the case, Staff's rate design is based upon traditional rate design principles, which more closely align customer's bills with the ECOS study. (Staff RB, 41.) Staff's rate design sets customer charges based upon ECOS Study customer costs and distribution charges based upon ECOS demand costs. However, as Staff has stated, it is not clear how Mr. Rubin derives his fixed cost percentages for non-heating customers. There may be public policy reasons for setting the fixed cost recovery at a certain percentage level, but unfortunately the AG did not provide any evidence to verify that its proposed figure is a sound figure. As the AG witness states, PGL's ECOS study shows that 93% of non-heating costs are customer related. (AG/ELPC Ex. 3.0, 16.)

The AG also states that NS' ECOS study shows 93% of non-heating costs are customer related. (*Id.*, 27.) The AG witness emphasizes that these are the maximum amount of costs that should be collected through the customer charge because the percentages from the ECOS studies assume that it is proper to recover all distribution-related costs that are classified as customer-related through the customer charge. The AG argues that traditionally NS and PGL collected a portion of those customer-related distribution costs through a volumetric charge. (*Id.*, 16 and 26-27.) However, the AG has not provided any type of evidence to justify that the distribution-related costs that are classified as customer-related should just be classified as distribution-related. (Staff RB, 52.)

The AG also focuses on the percentage of revenues that are collected through the customer charge. The AG states that Staff's customer charges recover too large of a percentage of revenues compared to ComEd and Ameren. (AG BOE, 23.) However, ComEd's and Ameren's percentage of revenues recovered through customer charges are based upon each Company's ECOS study. (ICC Staff Ex. 4.0, 17-18.) Likewise, Staff's proposed customer charges for Peoples Gas and North Shore are based upon the customer costs found in the Companies' ECOS studies. The AG has not shown how its proposed customer charges are cost based. Simply lowering the amount of revenues recovered through the customer charge just because other Companies have lower customer charges, is not a reflection of cost causation.

Additionally, the AG states that the Proposed Order sets rates based on Staff's rate design under the Companies' proposed revenue requirement, rather than the modified rate increase approved in the Proposed Order. (AG BOE 37.) Staff's

proposed language in the BOE addresses the AG's concerns. Furthermore, the language in the ALJPO correctly states that the customer charges should be adjusted to recover the final ECOS study customer costs. (ALJPO, 196.) However, if the ALJ deems it necessary to clarify how rates should be determined, Staff recommends the following modifications to the "Commission Analysis and Conclusion" section of the ALJPO on page 196:

~~The Commission accepts Staff's rate design proposal for this customer class, which reflects a more traditional rate design whereby customer charges recover embedded cost-of-service ("ECOS") study customer costs and distribution charges recover ECOS study demand costs. Therefore, customer's bills are more closely aligned with the ECOS study. If North Shore's total customer charge revenues derived from the proposed customer charge (\$15.80) are greater than the customer costs found on the final Commission approved ECOS study in this proceeding, then the final customer charge should be lowered to recover ECOS study-based customer costs only. Likewise if Peoples Gas' total customer charge revenues derived from the proposed customer charge (\$16.70) are greater than the customer costs found on the final Commission approved ECOS study in this proceeding, then the final customer charge should be lowered to recover ECOS study customer costs only. The customer charges for the S.C. No. 1 Small Residential Service, Non-Heating class should be set to recover the final Commission approved ECOS studies' customer costs. The remaining, non-storage related demand costs, would be recovered through a flat distribution charge on a per therm basis. The Commission orders that increases in the revenue requirement for non-storage demand-classified distribution costs shall be collected through volumetric charges.~~

Response to ELPC

The ELPC rejects the ALJPO's proposal to accept Staff's rate design proposal. The ALJPO recommends the acceptance of the AG's S.C. No. 1 Small Residential Service, Non-Heating rate design proposal. (ELPC BOE, 2-7.) For the same reasons provided in Staff's response to the AG, ELPC's arguments in support of the AG's S.C. No. 1 Small Residential Service, Non-Heating rate design should be rejected.

The ALJPO correctly accepts Staff's proposed S.C. No. 1 Small Residential Service, Non-Heating rate design for the reasons stated above.

b. Service Classification No. 1, Small Residential Service, Heating

Response to NS PGL

The Companies reject the ALJPO's conclusion regarding the S.C. No. 1 Small Residential Service, Heating classes' rate design. They state that the ALJPO's acceptance of Staff's rate design is flawed because it is inconsistent with cost-based rate design. (NS PGL BOE, 59.) The Companies repeat their points that were addressed in the Fixed Cost Recovery Section IX.B.2.

Staff will not repeat its arguments that are discussed in the Fixed Cost Recovery section of this RBOE. The ALJPO correctly accepts Staff's rate design proposal for the class.

Response to AG

The AG makes the same arguments concerning the S.C. No. 1 Small Residential Service, Heating rate design as it does for the Non-Heating class. The AG continues to reject the ALJPO's proposal to accept Staff's rate design proposal. The AG recommends that the ALJPO accept its rate design proposal that recovers some customer related costs through the distribution charge. The AG states that Staff's proposal actually increases fixed cost recovery and therefore should be rejected. (AG BOE, 20-21.) However, as Staff has discussed through out the case, Staff's rate design is based upon traditional rate design principles, which more closely align customer's bills with the ECOS study. (Staff RB, 41.) Staff's rate design sets customer charges based upon ECOS Study customer costs and distribution charges based upon ECOS

demand costs. As Staff has stated, it is not clear how the AG witness derives his fixed cost percentages for heating customers. There may be public policy reasons for setting the fixed cost recovery at a certain percentage level but unfortunately the AG did not provide any evidence to verify that its proposed figure is a sound figure. As the AG witness states, PGL's ECOS study shows that 64% of heating costs are customer related. (AG/ELPC Ex. 3.0, 16.) The AG also states that NS' ECOS study shows 67% of heating costs are customer related. (*Id.*, 27.) Rather than use these studies' results, the AG witness considers them as the maximum amount of costs that should be collected through the customer charge. However, the AG has not provided any type of evidence to justify deviating from the ECOS studies' results and instead selecting an arbitrary percentage. (Staff RB, 54.) The AG's only support appears to be the inadequate argument that traditionally NS and PGL collected a portion of those customer-related distribution costs through a volumetric charge. (*Id.*, 16 and 26-27.)

The AG also focuses on the percentage of revenues that are collected through the customer charge. The AG states that Staff's customer charges recover too large of a percentage of revenues compared to ComEd and Ameren. (AG BOE, 23.) However, ComEd's and Ameren's percentage of revenues recovered through customer charges are respectively based upon each company's ECOS study. (Staff Ex. 4.0, 17-18.) Likewise, Staff's proposed customer charges for Peoples Gas and North Shore are based upon the customer costs found in the Companies' respective ECOS studies. The AG has not shown how its proposed customer charges are cost based. Simply lowering the amount of revenues recovered through the customer charge just because other companies have lower customer charges, is not a reflection of cost causation.

Additionally, the AG states that the Proposed Order sets rates based on Staff's rate design under the Companies' proposed revenue requirement, rather than the modified rate increase approved in the Proposed Order. (AG BOE 37.) Staff's proposed language in the BOE should address the AG's concerns. Furthermore, the language in the ALJPO correctly states that the customer charges should be adjusted to recover the final ECOS study customer costs. (ALJPO, 196.) Staff does not believe other changes are necessary. However, if the ALJ deems it necessary to clarify how rates should be determined, Staff recommends the following modifications to the "Commission Analysis and Conclusion" section of the ALJPO on page 209:

~~The Commission finds that the Companies proposed increases in the customer charges pursuant to its SFV-based rate design are inconsistent with public policy as discussed in Section IX, B 2 (Fixed Cost Recovery) of this order. The Commission finds that Staff's and Intervenor's arguments in favor of assigning demand based costs to volumetric charges are consistent with energy efficiency and the avoidance of cross subsidies. The Commission accepts Staff's rate design proposal for this customer class, which reflects a more traditional rate design whereby customer charges recover embedded cost-of-service ("ECOS") study customer costs and distribution charges recover ECOS study demand costs. Therefore, customer's bills are more closely aligned with the ECOS study. The Commission finds that a \$25 monthly customer charge North Shore is appropriate. The Commission also finds that a \$32.35 monthly customer charge for Peoples Gas customers is appropriate. If North Shore's total customer charge revenues derived from the proposed customer charge (\$25) are greater than the customer costs found on the final Commission approved ECOS study in this proceeding, then the final customer charge should be lowered to recover ECOS study-based customer costs only. Likewise if Peoples Gas' total customer charge revenues derived from the proposed customer charge (\$32.35) are greater than the customer costs found on the final Commission approved ECOS study in this proceeding, then the final customer charge should be lowered to recover ECOS study customer costs only. The Commission orders that increases in the revenue requirement for non-storage demand-classified distribution costs shall be collected through volumetric charges. The customer charges for the S.C. No. 1 Small Residential Service, Heating class should be set to recover the final Commission approved ECOS studies' customer costs. The remaining, non-storage related demand costs, would be recovered through a flat distribution charge on a per therm basis.~~

Response to ELPC

The ELPC rejects the ALJPO's proposal to accept Staff's rate design proposal. The ALJPO recommends the acceptance of the AG's S.C. No. 1 Small Residential Service, Heating rate design proposal. (ELPC BOE, 2-7.) For the same reasons provided in Staff's response to the AG, ELPC's arguments in support of the AG's S.C. No. 1 Small Residential Service, Heating rate design should be rejected.

The ALJPO correctly accepts Staff's proposed S.C. No. 1 Small Residential Service, Heating rate design for the reasons stated above.

c. Service Classification No. 2, General Service

Response to NS PGL

The Companies reject the ALJPO's conclusion regarding the S.C. No. 2 General Service classes' rate design. They state that the ALJPO's acceptance of Staff's rate design is flawed because it is inconsistent with cost-based rate design. (NS PGL BOE, 61.) The Companies repeat their points that were addressed in the Fixed Cost Recovery Section IX.B.2.

Staff will not repeat its arguments that are discussed in the Fixed Cost Recovery section. The ALJPO correctly accepts Staff's rate design proposal for the class.

The Companies also correctly identify that the ALJPO incorrectly describes Staff proposed rate design for S.C. No. 1 Heating in the S.C. No. 2 General Service section. Staff agrees with the Company and has addressed this issue in its BOE.

d. Service Classification No. 4, Large Volume Demand Service

3. Classification of SC No. 1 Residential Heating and Non-Heating Customers

D. Other Rate Design Issues

1. Terms and Conditions of Service

a. Service Activation

b. Service Reconnection Charges

c. Second Pulse Data Capability Charge

2. Riders

a. Rider 5, Gas Service Pipe

b. Rider SSC, Storage Service Charge

c. Rider QIP, Qualifying Infrastructure Plant [PGL]

d. Rider UEA, Uncollectible Expense Adjustment, and Rider UEA-GC, Uncollectible Expense Adjustment – Gas Costs

e. Rider VBA, Volume Balancing Adjustment, Percentage of Fixed Costs

f. Transportation Riders

i. Transportation Administrative Charges

ii. Rider SBO Credit

iii. Purchase of Receivables

3. Service Classifications

a. S.C. Nos. 1 and 2 Terms of Service

4. Other

X. FINDINGS AND ORDERING PARAGRAPHS

XI. CONCLUSION

Staff respectfully requests that the Illinois Commerce Commission approve Staff's recommendations in this consolidated docket.

Respectfully submitted,

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